K12 INC
Form 10-Q
February 05, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-33883

K12 Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**95-4774688** (IRS Employer Identification No.)
2300 Corporate Park Drive **Herndon, VA** (Address of principal executive offices)	**20171** (Zip Code)

(703) 483-7000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of January 28, 2013, the Registrant had 37,102,938 shares of common stock, $0.0001 par value per share outstanding.

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For the Quarterly Period Ended December 31, 2012

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements (Unaudited).***

K12 INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

		December 31, 2012		June 30, 2012
		(In thousands, except share and per share data)		
ASSETS				
Current assets				
Cash and cash equivalents	$	143,192	$	144,652
Restricted cash and cash equivalents				1,501
Accounts receivable, net of allowance of $2,970 and $1,624 at December 31, 2012 and June 30, 2012, respectively		223,312		160,922
Inventories, net		29,470		37,853
Current portion of deferred tax asset		12,363		16,140
Prepaid expenses		19,833		11,173
Other current assets		16,000		14,598
Total current assets		444,170		386,839
Property and equipment, net		63,134		55,903
Capitalized software, net		39,639		34,709
Capitalized curriculum development costs, net		62,926		60,345
Intangible assets, net		34,437		36,736
Goodwill		61,501		61,619
Investment in Web International		10,000		10,000
Deposits and other assets		2,902		2,684
Total assets	$	718,709	$	648,835
LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND EQUITY				
Current liabilities				
Accounts payable	$	20,121	$	23,951
Accrued liabilities		22,218		13,802
Accrued compensation and benefits		13,296		17,355
Deferred revenue		59,249		25,410
Current portion of capital lease obligations		19,799		15,950
Current portion of note payable		1,138		1,145
Total current liabilities		135,821		97,613
Deferred rent, net of current portion		8,679		6,974
Capital lease obligations, net of current portion		20,619		15,124
Note payable, net of current portion				777
Deferred tax liability		34,764		31,591
Other long term liabilities		2,146		1,908
Total liabilities		202,029		153,987
Commitments and contingencies				
Redeemable noncontrolling interest		17,200		17,200
Equity:				

K12 Inc. stockholders equity				
Common stock, par value $0.0001; 100,000,000 shares authorized; 36,872,800 and 36,436,933 shares issued and outstanding at December 31, 2012 and June 30, 2012, respectively		4		4
Additional paid-in capital		527,574		519,439
Series A Special Stock, par value $0.0001; 2,750,000 shares authorized, issued and outstanding at December 31, 2012 and June 30, 2012		63,112		63,112
Accumulated other comprehensive (loss) income		(50)		100
Accumulated deficit		(95,293)		(109,161)
Total K12 Inc. stockholders equity		495,347		473,494
Noncontrolling interest		4,133		4,154
Total equity		499,480		477,648
Total liabilities, redeemable noncontrolling interest and equity	$	718,709	$	648,835

See accompanying notes to unaudited condensed consolidated financial statements.

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K12 INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
	(In thousands, except share and per share data)			
Revenues	$ 206,028	$ 166,500	$ 427,124	$ 359,830
Cost and expenses				
Instructional costs and services	122,799	98,909	241,446	200,016
Selling, administrative, and other operating expenses	61,379	52,925	150,998	130,656
Product development expenses	5,578	7,574	9,746	13,798
Total costs and expenses	189,756	159,408	402,190	344,470
Income from operations	16,272	7,092	24,934	15,360
Interest expense, net	(272)	(236)	(501)	(457)
Income before income tax expense and noncontrolling interest	16,000	6,856	24,433	14,903
Income tax expense	(6,680)	(2,976)	(10,569)	(6,673)
Net income	9,320	3,880	13,864	8,230
Adjust net loss attributable to noncontrolling interest	191	285	4	536
Net income attributable to common stockholders, including Series A stockholders	$ 9,511	$ 4,165	$ 13,868	$ 8,766
Net income attributable to common stockholders per share, excluding Series A stockholders:				
Basic	$ 0.24	$ 0.11	$ 0.36	$ 0.23
Diluted	$ 0.24	$ 0.11	$ 0.36	$ 0.23
Weighted average shares used in computing per share amounts:				
Basic	36,118,519	35,755,685	36,073,885	35,692,761
Diluted	36,118,519	35,976,779	36,073,885	36,009,878

See accompanying notes to unaudited condensed consolidated financial statements.

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K12 INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF

COMPREHENSIVE INCOME (LOSS)

	Three Months Ended December 31,				Six Months Ended December 31,			
	2012		2011		2012		2011	
	(In thousands)							
Net income	$	9,320	$	3,880	$	13,864	$	8,230
Other comprehensive income, net of tax								
Foreign currency translation adjustment		164		24		(150)		106
Total other comprehensive income, net of tax		9,484		3,904		13,714		8,336
Comprehensive (loss) income attributable to noncontrolling interest		191		285		4		536
Comprehensive income attributable to common stockholders, including Series A stockholders	$	9,675	$	4,189	$	13,718	$	8,872

See accompanying notes to unaudited condensed consolidated financial statements.

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K12 INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF EQUITY (DEFICIT)

	K12 Inc Stockholders									
(In thousands, except share data)	Common Stock Shares	Common Stock Amount	Common Stock - Series A Shares	Common Stock - Series A Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling Interest	Total
Balance, June 30, 2012	36,436,933	$ 4	2,750,000	$ 63,112	$ 519,439	$ 100	$ (109,161)	$ 4,154	$ 477,648
Net income (loss) (1)							13,868	(21)	13,847
Other comprehensive loss						(150)			(150)
Stock based compensation expense					5,780				5,780
Exercise of stock options	69,989				607				607
Excess tax benefit from stock-based compensation					2,532				2,532
Issuance of restricted stock awards	404,073								
Accretion of redeemable noncontrolling interests to estimated redemption value					17				17
Retirement of restricted stock for tax withholding	(38,195)				(801)				(801)
Balance, December 31, 2012	36,872,800	$ 4	2,750,000	$ 63,112	$ 527,574	$ (50)	$ (95,293)	$ 4,133	$ 499,480

(1) Net income (loss) attributable to noncontrolling interests excludes $0.1 million due to the redeemable noncontrolling interest related to Middlebury Interactive Languages, which is reported outside of permanent equity in the accompanying unaudited condensed consolidated balance sheets.

See accompanying notes to unaudited condensed consolidated financial statements.

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K12 INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended December 31, 2012	2011
	(In thousands)	
Cash flows from operating activities		
Net income	$ 13,864	$ 8,230
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	31,894	27,668
Stock based compensation expense	5,780	4,724
Excess tax benefit from stock based compensation	(2,532)	(1,232)
Deferred income taxes	9,482	6,433
Provision for doubtful accounts	784	329
Provision for inventory obsolescence	200	9
Provision for student computer shrinkage and obsolescence	502	393
Changes in assets and liabilities:		
Accounts receivable	(63,338)	(100,765)
Inventories	8,183	10,341
Prepaid expenses	(8,630)	(3,400)
Other current assets	(1,402)	(5,199)
Deposits and other assets	(217)	151
Accounts payable	(3,838)	(928)
Accrued liabilities	8,403	2,885
Accrued compensation and benefits	(4,058)	575
Deferred revenue	33,529	29,906
Release of restricted cash	1,501	
Deferred rent and other long term liabilities	1,945	413
Net cash provided by (used in) operating activities	32,052	(19,467)
Cash flows from investing activities		
Purchase of property and equipment	(4,524)	(6,276)
Capitalized software development costs	(11,633)	(8,626)
Capitalized curriculum development costs	(9,628)	(6,469)
Purchase of acquired entity		(12,641)
Net cash used in investing activities	(25,785)	(34,012)
Cash flows from financing activities		
Repayments on capital lease obligations	(9,851)	(7,884)
Repayments on note payable	(785)	(1,069)
Proceeds from exercise of stock options	607	2,760
Excess tax benefit from stock based compensation	2,532	1,232
Repurchase of restricted stock for income tax withholding	(801)	(580)
Payment of stock registration expense		(313)
Net cash used in financing activities	(8,298)	(5,854)
Effect of foreign exchange rate changes on cash and cash equivalents	571	106
Net change in cash and cash equivalents	(1,460)	(59,227)
Cash and cash equivalents, beginning of period	144,652	193,099
Cash and cash equivalents, end of period	$ 143,192	$ 133,872

See accompanying notes to unaudited condensed consolidated financial statements.

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K12 Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Description of the Business

K12 Inc. and its subsidiaries (K12 or the Company) is a technology-based education company. The Company offers proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, (K-12). The Company s mission is to maximize a child s potential by providing access to an engaging and effective education, regardless of geographic location or socio-economic background. Since the Company s inception, the Company has invested approximately $330 million to develop and to a lesser extent, acquire curriculum and online learning platforms that promote mastery of core concepts and skills for students of all abilities. This learning system combines the Company s curriculum and offerings with an individualized learning approach well-suited for virtual and blended public schools, school district online programs, public charter schools and private schools that utilize varying degrees of online and traditional classroom instruction, and other educational applications. In contracting with a virtual or blended public school, the Company typically provides students with access to the K12 online curriculum, offline learning kits and the use of a personal computer in certain cases, in addition to providing management services. The Company provides management services to public schools in 33 states and the District of Columbia.

In addition, the Company works closely with a growing number of public schools, school districts, private schools and public charter schools enabling them to offer their students an array of solutions, including full-time virtual programs, semester course and supplemental solutions. In addition to curriculum, systems and programs, the Company provides teacher training, teaching services and other support services.

2. Basis of Presentation

The accompanying condensed consolidated balance sheet as of December 31, 2012, the condensed consolidated statements of operations for the three and six months ended December 31, 2012 and 2011, the condensed consolidated statements of cash flows for the six months ended December 31, 2012 and 2011, the condensed consolidated statement of comprehensive income (loss) and the condensed consolidated statement of equity (deficit) for the six months ended December 31, 2012 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company s financial position as of December 31, 2012, the results of operations for the three and six months ended December 31, 2012 and 2011, cash flows for the six months ended December 31, 2012 and 2011, the condensed consolidated statements of comprehensive income (loss) for the three and six months ended December 31, 2012 and 2011, and the condensed consolidated statement of equity (deficit) for the six months ended December 31, 2012. The results of the three and six month periods ended December 31, 2012 are not necessarily indicative of the results to be expected for the year ending June 30, 2013 or for any other interim period or for any other future fiscal year. The consolidated balance sheet as of June 30, 2012 has been derived from the audited consolidated financial statements at that date.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended (the Exchange Act). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, these statements include all adjustments (consisting of normal recurring adjustments) considered necessary to present a fair statement of the Company s condensed consolidated results of operations, financial position and cash flows. Preparation of the Company s financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and footnotes. Actual results could differ from those estimates. This quarterly report on Form 10-Q should be read in conjunction with the financial statements and the notes thereto included in the Company s annual report on Form 10-K filed with the Securities and Exchange Commission (the SEC) on September 12, 2012, which contains the Company s audited financial statements for the fiscal year ended June 30, 2012.

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The Company operates in one operating and reportable business segment as a technology based education company providing proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade. The Chief Operating Decision Maker evaluates profitability based on consolidated results.

3. Summary of Significant Accounting Policies

Revenue Recognition

Revenues are principally earned from long-term contractual agreements to provide online curriculum, books, materials, computers and management services to virtual and blended public schools, traditional schools, school districts, public charter schools, and private schools. In addition to providing the curriculum, books and materials, under its contracts, the Company provides management services to virtual and blended public schools, including monitoring academic achievement, recommendations related to teacher hiring and training and compensation of school personnel, financial management, enrollment processing and procurement of curriculum, equipment and required services. The schools receive funding on a per student basis from the state in which the public school or school district is located. Shipments for schools that occur in the fourth fiscal quarter and for the upcoming school year are recorded in deferred revenues.

Where the Company has determined that it is the primary obligor for substantially all expenses under these contracts, the Company records the associated per student revenue received by the school from its state funding school district up to the expenses incurred in accordance with Accounting Standards Codification (ASC) 605, *Revenue Recognition*. For contracts where the Company is not the primary obligor, the Company records revenue based on its net fees earned under the contractual agreement.

The Company generates revenues under contracts with virtual and blended public schools which include multiple elements. These elements include providing each school s students with access to the Company s online school and the component of lessons; offline learning kits, which include books and materials to supplement the online lessons; in certain cases may include the use of a personal computer and associated reclamation services; internet access and technology support services; the services of a state-certified teacher; and management and technology services required to operate a virtual public or blended school. In certain managed school contracts, revenue is determined directly by per enrollment funding. Revenue is generally recognized ratably over the period services are performed except for revenue on materials that is recognized upon shipment to students and the costs of materials are expensed.

The Company has determined that the elements of its contracts are valuable to schools in combination, but do not have standalone value. As a result, the elements within the Company s multiple-element contracts do not qualify for separate units of accounting. Accordingly, the Company accounts for revenues under multiple element arrangements as a single unit of accounting and recognizes the entire arrangement based upon the approximate rate at which it incurs the costs associated with each element.

Under the contracts where the Company provides turnkey management services to schools, the Company has generally agreed to absorb any operating losses of the schools. These school operating losses represent the excess of costs incurred over revenues earned by the virtual or blended public school as reflected on its respective financial statements, including Company charges to the schools. A school operating loss in one year does not necessarily mean the Company anticipates losing money on the entire contract with the school. However, a school operating loss may reduce the Company s ability to collect its fees in full and recognized revenues are reduced accordingly to reflect the expected cash collections from such schools. The Company amortizes the estimated school operating loss against its management fees based upon the percentage of actual revenues in the period to total estimated revenues for the fiscal year. Management periodically reviews its estimates of full year school revenues and operating expenses and amortizes the net impact of any changes to these estimates over the remainder of the fiscal year. Actual school operating losses may vary from these estimates or revisions, and the impact of these differences could have a material impact on results of operations. Since the end of the school year coincides with the end of the Company s fiscal year, annual revenues are generally based on actual school revenues and actual costs incurred in the calculation of school operating losses.

The Company provides certain online curriculum and services to schools and school districts under subscription and perpetual license agreements. Revenue under these agreements is recognized in accordance with ASC 605

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when all of the following conditions are met: there is persuasive evidence of an arrangement; delivery has occurred or services have been rendered; the amount of fees to be paid by the customer is fixed and determinable; and the collectability of the fee is probable. Revenue from the licensing of curriculum under subscription arrangements is recognized on a ratable basis over the subscription period. Revenue from the licensing of curriculum under non-cancelable perpetual arrangements is recognized when all revenue recognition criteria have been met. Revenue from professional consulting, training and support services are deferred and recognized ratably over the service period.

Other revenues are generated from individual customers who prepay and have access for 12 to 24 months to Company-provided online curriculum. The Company recognizes these revenues pro rata over the maximum term of the customer contract. Revenues from associated offline learning kits are recognized upon shipment.

During the three months ended December 31, 2012, the Company had contracts with two schools that represented approximately 14% and 11% of revenues. During the three months ended December 31, 2011, the Company had contracts with two schools that each represented approximately 8% of revenues. The percentage of revenues for these two schools is not indicative of the percentage of revenues for the full year. Approximately 8% and 11% of accounts receivable was attributable to a contract with one school as of December 31, 2012 and June 30, 2012, respectively. During the six months ended December 31, 2012, the Company had contracts with two schools that represented approximately 14% and 10% of revenues. During the six months ended December 31, 2011, the Company had contracts with two schools that each represented approximately 8% of revenues.

Reclassifications

The Company has reclassified certain prior year enrollment related costs from instructional costs and services to selling administrative and other operating expenses to conform to the current year presentation. There was no effect on total costs and expenses, income from operations or net income from such reclassification.

Consolidation

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned and affiliated companies that the Company owns, directly or indirectly, and all controlled subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Inventories

Inventories consist primarily of textbooks and curriculum materials, a majority of which are supplied to virtual public schools and blended public schools and utilized directly by students. Inventories represent items that are purchased and held for sale and are recorded at the lower of cost (first-in, first-out method) or market value. Excess and obsolete inventory reserves are established based upon the evaluation of the quantity on hand relative to demand. The excess and obsolete inventory reserve was $4.7 million and $4.5 million at December 31, 2012 and June 30, 2012, respectively

Other Current Assets

Other current assets consist primarily of textbooks, curriculum materials and other supplies which are expected to be returned upon the completion of the school year. Materials not returned are expensed as part of instructional costs and services.

Property and Equipment

Property, equipment and capitalized software development costs are stated at cost less accumulated depreciation and amortization. Depreciation expense is calculated using the straight-line method over the estimated useful life of the asset (or the lesser of the term of the lease and the estimated useful life of the asset under capital lease). Amortization of assets capitalized under capital lease arrangements is included in depreciation expense. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful life of the asset. The Company determines the lease term in accordance with ASC 840, *Leases*, as the fixed non-cancelable term of the lease plus all periods for which failure to renew the lease imposes a penalty on the lessee in an amount such that renewal appears, at the inception of the lease, to be reasonably assured. Property and equipment are depreciated over the following useful lives:

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	Useful Life
Student computers	3 years
Computer hardware	3 years
Computer software	3-5 years
Web site development costs	3 years
Office equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	3-12 years

Capitalized Software

The Company develops software for internal use. Software development costs incurred during the application development stage are capitalized in accordance with ASC 350, *Intangibles Goodwill and Other*. The Company amortizes these costs over the estimated useful life of the software, which is generally three years. Capitalized software development costs are stated at cost less accumulated amortization.

Capitalized software development additions totaled $11.6 million and $8.6 million for the six months ended December 31, 2012 and 2011, respectively. Amortization expense for the three months ended December 31, 2012 and 2011 was $3.4 million and $3.1 million, respectively. Amortization expense for the six months ended December 31, 2012 and 2011 was $6.7 million and $5.8 million, respectively.

Capitalized Curriculum Development Costs

The Company internally develops its own curriculum, which is primarily provided as online content and accessed via the Internet. The Company also creates textbooks and other materials that are complementary to online content.

The Company capitalizes curriculum development costs incurred during the development stage in accordance with ASC 350. The Company capitalizes curriculum development costs during the design and deployment phases of the project. Many of the Company s new courses leverage off of proven delivery platforms and are primarily content, which has no technological hurdles. As a result, a significant portion of the Company s courseware development costs qualify for capitalization due to the concentration of its development efforts on the content of the courseware. Capitalization ends when a course is available for general release to its customers, at which time amortization of the capitalized costs begins. The period of time over which these development costs will be amortized is generally five years.

Total capitalized curriculum development additions were $9.6 million and $6.5 million for the six months ended December 31, 2012 and 2011, respectively. These amounts are recorded on the accompanying consolidated balance sheet net of amortization charges. Amortization is recorded in product development expenses on the accompanying condensed consolidated statements of operations. Amortization expense for the three months ended December 31, 2012 and 2011 was $3.6 million and $3.1 million, respectively. Amortization expense for the six months ended December 31, 2012 and 2011 was $7.1 million and $6.0 million, respectively.

Income Taxes

The Company accounts for income taxes in accordance with ASC 740, *Income Taxes*. Under ASC 740, deferred tax assets and liabilities are computed based on the difference between the financial reporting and income tax bases of assets and liabilities using the enacted marginal tax rate. ASC 740 requires that the net deferred tax asset be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the net deferred tax asset will not be realized.

Series A Special Stock

The Company issued 2,750,000 shares of Series A Special Stock in connection with an acquisition. The holders of the Series A Special Stock have the right to convert those shares into common stock on a one-for-one basis and the right to vote on all matters presented to K12 stockholders, other than for the election and removal of directors, for which holders of the Series A Special Stock have no voting rights.

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Noncontrolling Interest

Earnings or losses attributable to other stockholders of a consolidated affiliated company are classified separately as noncontrolling interest in the Company s condensed consolidated statements of operations. Net income attributable to noncontrolling interest reflects only the Company s share of the after-tax earnings or losses of an affiliated company. Income taxes attributable to noncontrolling interest are determined using the applicable statutory tax rates in the jurisdictions where such operations are conducted. These rates vary from country to country. The Company s condensed consolidated balance sheets reflect noncontrolling interest within the equity section of the condensed consolidated balance sheets rather than in the mezzanine section of the condensed consolidated balance sheets, except for redeemable noncontrolling interest. Noncontrolling interest is classified separately in the Company s condensed consolidated statement of equity (deficit).

Redeemable Noncontrolling Interests

Noncontrolling interests in subsidiaries that are redeemable outside of the Company s control for cash or other assets are classified outside of permanent equity at redeemable value which approximates fair value. The redeemable noncontrolling interests will be adjusted to their fair value at each balance sheet date. The resulting increases or decreases in the estimated redemption amount are affected by corresponding charges against retained earnings, or in the absence of retained earnings, additional paid-in-capital.

Goodwill and Intangible Assets

The Company records as goodwill the excess of purchase price over the fair value of the identifiable net assets acquired. Finite-lived intangible assets acquired in business combinations subject to amortization are recorded at their fair value. Finite-lived intangible assets include trade names, customer and distributor relationships and developed technology. Such intangible assets are amortized on a straight-line basis over their estimated useful lives. Amortization expense for the three months ended December 31, 2012 and 2011 was $1.1 million and $0.9 million, respectively. Amortization expense for the six months ended December 31, 2012 and 2011 was $2.3 million and $1.8 million, respectively. Future amortization of intangible assets is $2.3 million, $3.1 million, $3.1 million, $3.0 million and $2.4 million in the fiscal years ending June 30, 2013 through June 30, 2017, respectively, and $20.4 million thereafter. As of December 31, 2012 and June 30, 2012, goodwill balances were recorded at $61.5 million and $61.6 million, respectively.

The Company reviews its recorded finite-lived intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between fair value and the carrying value of the asset.

ASC 350 prescribes a process for impairment testing of goodwill and intangibles with indefinite lives, which is performed annually, as well as when an event triggering impairment may have occurred. Goodwill and intangible assets deemed to have an indefinite life are tested for impairment on an annual basis, or earlier when events or changes in circumstances suggest the carrying amount may not be fully recoverable. The Company has elected to perform its annual assessment on May 31st of each year.

During the first six months of fiscal year 2013, the Company s goodwill decreased by approximately $0.1 million due to adjustments made related to the acquisition of certain K-12 assets and Insight School management contracts of Kaplan Virtual Education (KVE), a subsidiary of Kaplan Inc. (the Kaplan/Insight Assets) (see Note 10) in connection with the finalization of the purchase price allocation.

The following table represents goodwill additions during the six months ended December 31, 2012:

Rollforward of Goodwill		**Amount ($ in millions)**
Balance as of June 30, 2012	$	61.6
Adjustments due to KVE and other foreign exchange translations		(0.1)
Balance as of December 31, 2012	$	61.5

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The following table represents the balance of intangible assets as of December 31 and June 30, 2012:

Intangible Assets

	December 31, 2012			June 30, 2012		
($ in millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade names	$ 24.0	$ (3.8)	$ 20.2	$ 24.0	$ (3.1)	$ 20.9
Customer and distributor relationships	18.9	(5.4)	13.5	18.9	(4.0)	14.9
Developed technology	1.5	(1.1)	0.4	1.5	(0.9)	0.6
Other	0.5	(0.2)	0.3	0.5	(0.2)	0.3
	$ 44.9	$ (10.5)	$ 34.4	$ 44.9	$ (8.2)	$ 36.7

Impairment of Long-Lived Assets

Long-lived assets include property, equipment, capitalized curriculum and software developed or obtained for internal use. In accordance with ASC 360, the Company reviews its recorded long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between fair value and the carrying value of the asset. There was no impairment charge for the period ended December 31, 2012.

Fair Value Measurements

ASC 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

ASC 820 describes three levels of inputs that may be used to measure fair value:

Level 1: Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Inputs reflect management s best estimate of what market participants would use in pricing the asset or liability at the measurement date. The inputs are unobservable in the market and significant to the instrument s valuation.

The carrying values reflected in the accompanying condensed consolidated balance sheets for cash and cash equivalents, receivables, inventory and debt approximate their fair values.

The redeemable noncontrolling interest is a result of the Company s joint venture with Middlebury College to form Middlebury Interactive Languages. Under the agreement, Middlebury College has an irrevocable election to sell all (but not less than all) of its membership interest to the Company (put right). The fair value of the redeemable noncontrolling interest reflects management s best estimate of the redemption of the put right.

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The following table summarizes certain information at December 31, 2012 for assets and liabilities measured at fair value on a recurring basis:

Description	Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Redeemable Noncontrolling Interest in Middlebury Joint Venture	$ 17,200	$	$	$ 17,200
Investment in Web International Education Group, Ltd	10,000			10,000
Total	$ 27,200	$	$	$ 27,200

The following table summarizes certain information at June 30, 2012 for assets and liabilities measured at fair value on a recurring basis:

Description	Fair Value	Fair Value Measurements Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Inputs (Level 3)
		(In thousands)		
Redeemable Noncontrolling Interest in Middlebury Joint Venture	$ 17,200	$	$	$ 17,200
Investment in Web International Education Group, Ltd	10,000			10,000
Total	$ 27,200	$	$	$ 27,200

The following table presents activity related to the Company s fair value measurements categorized as Level 3 of the valuation hierarchy, valued on a recurring basis:

Description	Fair Value June 30, 2012	Six Months Ended December 31, 2012 Purchases, Issuances, and Settlements	Unrealized Gains/(Losses)	Fair Value December 31, 2012
		(In thousands)		
Redeemable Noncontrolling Interest in Middlebury Joint Venture	$ 17,200	$	$	$ 17,200
Investment in Web International Education Group, Ltd	10,000			10,000
Total	$ 27,200	$	$	$ 27,200

The fair value of the investment in Web International Education Group, Ltd. (Web) as of December 31, 2012 was estimated to be $10.0 million. The fair value was measured based on the initial cost of the investment and Web s operating performance since the initial investment as U.S. GAAP financial statements for Web are not available to more definitively determine fair value; there was no underlying change in its estimated market value. There have been no transfers in or out of Level 3 of the hierarchy for the period presented.

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The fair value of the redeemable noncontrolling interest in the Middlebury Joint Venture was measured in accordance with ASC 480, *Distinguishing Liabilities from Equity*, and was based upon a valuation from a third-party valuation firm as of June 30, 2012. As of December 31, 2012, the Company performed an internal analysis and determined there was no underlying change in the estimated fair market value. This analysis incorporated a number of assumptions and estimates including the financial results of the joint venture to date.

Net Income Per Common Share

The Company calculates net income per share in accordance with ASC 260, *Earnings Per Share*. Under ASC 260, basic net income per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the reporting period. The weighted average number of shares of common stock outstanding includes vested restricted stock awards. Diluted earnings per share (EPS) reflects the potential dilution that could occur assuming conversion or exercise of all dilutive unexercised stock options. The dilutive effect of stock options and restricted stock awards was determined using the treasury stock method. Under the treasury stock method, the proceeds received from the exercise of stock options and restricted stock awards, the amount of compensation cost for future service not yet recognized by the Company and the amount of tax benefits that would be recorded in additional paid-in capital when the stock options become deductible for income tax purposes are all assumed to be used to repurchase shares of the Company s common stock. Stock options and restricted awards are not included in the computation of diluted EPS when they are antidilutive. Common stock outstanding reflected in the Company s consolidated balance sheet includes restricted awards outstanding. Securities that may participate in undistributed earnings with common stock are considered participating securities. Since the shares of Series A Special stock participate in all dividends and distributions declared or paid with respect to common stock of the Company (as if a holder of common stock), the shares of Series A Special stock meet the definition of a participating security under ASC 260. All securities that meet the definition of a participating security, regardless of whether the securities are convertible, non-convertible or potential common stock securities, are included in the computation of both basic and diluted EPS (as a reduction of the numerator) using the two-class method. Under the two-class method, all undistributed earnings in a period are to be allocated to common stock and participating securities to the extent that each security may share in earnings as if all of the earnings for the period had been distributed.

The following schedule presents the calculation of basic and diluted net income per share:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
	(In thousands except shares and per share data)			
Basic earnings per share computation:				
Net income K12	$ 9,511	$ 4,165	$ 13,868	$ 8,766
Amount allocated to participating Series A stockholders	$ (675)	$ (297)	$ (984)	$ (627)
Income available to common stockholders basic	$ 8,836	$ 3,868	$ 12,884	$ 8,139
Weighted average common shares basic	36,118,519	35,755,685	36,073,885	35,692,761
Basic net income per share	$ 0.24	$ 0.11	$ 0.36	$ 0.23
Dilutive earnings per share computation:				
Net income K12	$ 9,511	$ 4,165	$ 13,868	$ 8,766
Amount allocated to participating Series A stockholders	$ (675)	$ (297)	$ (984)	$ (627)
Income available to common stockholders diluted	$ 8,836	$ 3,868	$ 12,884	$ 8,139
Share computation:				
Weighted average common shares basic	36,118,519	35,755,685	36,073,885	35,692,761

Effect of dilutive stock options and restricted stock awards		221,094		317,117
Weighted average common shares outstanding diluted	36,118,519	35,976,779	36,073,885	36,009,878
Diluted net income per share	$ 0.24	$ 0.11	$ 0.36	$ 0.23

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Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (the FASB) issued ASU 2011-05, *Presentation of Comprehensive Income*, which provides authoritative guidance on disclosure requirements for comprehensive income. This accounting update eliminated the option to present the components of other comprehensive income as part of the statement of stockholders equity. Instead, the Company must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. This guidance became effective for the Company beginning on July 1, 2012. The standard has been adopted and the presentation of comprehensive income (loss) has changed.

In July 2012, the FASB issued ASU 2012-02, *Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment,* which provides authoritative guidance on application of the impairment model for indefinite-lived intangible assets. This accounting update permits an entity to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that indefinite-lived intangible assets are impaired as part of its annual assessment. This guidance became effective for the Company beginning on July 1, 2012. The adoption of this standard did not have a material impact on its financial condition, results of operations or disclosures.

4. Income Taxes

The provision for income taxes is based on earnings reported in the condensed consolidated financial statements. A deferred income tax asset or liability is determined by applying currently enacted tax laws and rates to the expected reversal of the cumulative temporary differences between the carrying value of assets and liabilities for financial statement and income tax purposes. Deferred income tax expense or benefit is measured by the change in the deferred income tax asset or liability during the period. For the three months ended December 31, 2012 and 2011, the Company s effective income tax rate was 41.8% and 43.4%, respectively. For the six months ended December 31, 2012 and 2011, the Company s effective tax rate was 43.3% and 44.8%, respectively. The effective income tax rate differs from the statutory federal income tax rate of 35% primarily due to state income taxes, the impact of foreign operations, noncontrolling interests and certain expenses not deductible for income tax purposes.

5. Long-term Obligations

Capital Leases

The Company incurs capital lease obligations for student computers under a lease line of credit with PNC Equipment Finance, LLC with annual lease availability limits. The current annual availability of $35 million expires in August 2013. As of December 31, 2012, the aggregate outstanding balance under the lease line of credit was $40.4 million. Borrowings bore interest at rates ranging from 2.62% to 4.96% and included a 36-month payment term with a $1 purchase option at the end of the term. The Company has pledged the assets financed to secure the outstanding leases. The lease line of credit is subject to cross default compliance provisions in the Company s line of credit agreement. The Company may extend its lease line of credit for additional periods, or consider alternative arrangements for financing student computers.

As of December 31, 2012 and June 30, 2012, computer equipment under capital lease was recorded at a cost of $101.1 million and $81.9 million, respectively, with accumulated depreciation of $64.6 million and $54.4 million, respectively. The net carrying value of leased student computers as of December 31, 2012 and June 30, 2012 was $36.5 million and $27.5 million, respectively.

Note Payable

The Company has purchased computer software licenses and maintenance services through an unsecured note payable arrangement with a vendor at 2.8% interest rate and a payment term of three years. There are no covenants associated with this note payable arrangement. The balance of the note payable at December 31 and June 30, 2012 was $1.1 million and $1.9 million, respectively.

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The following is a summary as of December 31, 2012 of the present value of the net minimum payments due on outstanding capital leases and the note payable under the Company s commitments:

December 31,	Capital Leases	Note Payable ($ in thousands)	Total
2013	$ 20,580	$ 1,162	$ 21,742
2014	15,075		15,075
2015	6,121		6,121
Thereafter			
Total minimum payments	41,776	1,162	42,938
Less amount representing interest (imputed weighted average capital lease interest rate of 2.9%)	(1,358)	(24)	(1,382)
Net minimum payments	40,418	1,138	41,556
Less current portion	(19,799)	(1,138)	(20,937)
Present value of minimum payments, less current portion	$ 20,619	$	$ 20,619

6. Line of Credit

The Company has a $35.0 million unsecured line of credit that expires December 31, 2013 with PNC Bank, N.A., or PNC, for general corporate operating purposes. In December 2012, the Credit Agreement was amended to extend the maturity date until December 2013 and to release liens that had previously secured the facility. Interest is charged, at the Company s option, either at: (i) the higher of (a) the rate of interest announced by PNC from time to time as its prime rate , (b) the federal funds open rate plus 0.5% and (c) the Daily London Interbank Offered Rate (LIBOR) plus 1.0%; or (ii) the applicable London Interbank Offered Rate (LIBOR) divided by a number equal to 1.00, minus the maximum aggregate reserve requirement which is imposed on member banks of the Federal Reserve System against Eurocurrency liabilities plus 1.75%. The Credit Agreement includes a $5.0 million letter of credit facility. Issuance of letters of credit reduces the availability of permitted borrowings under the Credit Agreement.

The Credit Agreement contains a number of financial and other covenants that, among other things, restrict the Company s ability to incur additional indebtedness, grant liens or other security interests, make certain investments, become liable for contingent liabilities, make specified restricted payments, including dividends, dispose of assets or stock, including the stock of its subsidiaries, or make capital expenditures above specified limits and engage in other matters customarily restricted in senior credit facilities. The Company must not exceed a maximum debt leverage ratio or fall below a minimum fixed charge coverage ratio. These covenants are subject to certain qualifications and exceptions. As of December 31, 2012, the Company was in compliance with these covenants. As of December 31, 2012, no borrowings were outstanding on the line of credit and approximately $0.3 million was reserved for a letter of credit.

7. Stock Option Plan

Stock Options

Stock option activity during the six months ended December 31, 2012 was as follows:

	Shares		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)		Aggregate Intrinsic Value
Outstanding, June 30, 2012	2,949,940	$	20.41	4.21	$	36,916
Granted	222,009		21.30			
Exercised	(69,989)		8.64			
Forfeited or canceled	(322,790)		29.58			
Outstanding, December 31, 2012	2,779,170	$	20.59	4.02	$	8,254
Stock options exercisable at December 31, 2012	1,912,034	$	18.20	3.51	$	6,943

The aggregate intrinsic value of options exercised during the six months ended December 31, 2012 was $0.8 million. The weighted-average grant date fair value of options granted was $10.50 during the six months ended December 31, 2012.

As of December 31, 2012, there was $7.2 million of total unrecognized compensation expense related to unvested stock options granted. The cost is expected to be recognized over a weighted average period of 2.8 years. During the three months ended December 31, 2012 and December 31, 2011, the Company recognized $1.0 million and $1.1 million, respectively, of stock-based compensation expense related to stock options. During the six months ended December 31, 2012 and December 31, 2011, the Company recognized $2.1 million and $2.2 million, respectively, of stock-based compensation expense related to stock options.

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Restricted Stock Awards

Restricted stock award activity during the six months ended December 31, 2012 was as follows:

	Shares		Weighted-Average Fair Value
Outstanding, June 30, 2012	591,637	$	25.12
Granted	404,073		21.40
Vested	(136,325)		21.44
Forfeited or canceled	(12,697)		25.62
Outstanding, December 31, 2012	846,688	$	23.57

As of December 31, 2012, there was $12.6 million of total unrecognized compensation expense related to unvested restricted stock awards granted. The cost is expected to be recognized over a weighted average period of 2.1 years. The total fair value of shares vested during the six months ended December 31, 2012 was $2.9 million. During the three months ended December 31, 2012 and December 31, 2011, the Company recognized $1.9 million and $1.4 million, respectively, of stock-based compensation expense related to restricted stock awards. During the six months ended December 31, 2012 and December 31, 2011, the Company recognized $3.7 million and $2.5 million, respectively, of stock-based compensation expense related to restricted stock awards.

8. Related Party Transactions

For the six months ended December 31, 2012, the Company purchased services in the amount of $0.1 million from Knowledge Universe Technologies (KUT) pursuant to a Transition Services Agreement related to the Company s acquisition of KCDL, as well as other administrative services. KUT is an affiliate of Learning Group, LLC, a related party.

During fiscal year 2012, in accordance with the original terms of the joint venture agreement, the Company loaned $3.0 million to its 60% owned joint venture, Middlebury Interactive Languages. The loan is repayable under terms and conditions specified in the loan agreement. The loan balance and related interest are eliminated since Middlebury Interactive Languages is consolidated in the Company s financial statements; however, repayment of the loan is dependent on the continued liquidity of Middlebury Interactive Languages.

9. Commitments and Contingencies

Litigation

In the ordinary conduct of business, the Company is subject to lawsuits, arbitrations and administrative proceedings from time to time. The Company expenses legal costs as incurred.

IpLearn

On October 26, 2011, IpLearn, LLC (IpLearn) filed a complaint for patent infringement against the Company in the United States District Court for the District of Delaware, *IpLearn, LLC v. K12 Inc.,* Case No. 1:11-1026-LPS, which it subsequently amended on November 18, 2011. IpLearn is a privately-held technology development and licensing company for web and computer-based learning technologies. In its complaint, IpLearn alleges that the Company has infringed three of its patents for various computer-aided learning methods and systems. On July 2, 2012, the Court granted the Company s motion to dismiss IpLearn s allegations of indirect patent infringement and allowed IpLearn s allegations of direct patent infringement to proceed. On January 15, 2013, the court approved a stay of IpLearn s claims alleging infringement of one of the three patents in the case involving technology licensed to K12 by a third party. The discovery process is currently in progress.

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Hoppaugh Complaint and Related Matters

On January 30, 2012, a securities class-action lawsuit captioned *David Hoppaugh* et al. *v. K12 Inc.* et. al., was filed against the Company and two of its officers in the United States District Court for the Eastern District of Virginia, Case No. I:12-CV-00103-CMH-IDD. On May 18, 2012, the Court appointed the Arkansas Teacher Retirement System as lead plaintiff, and it filed an amended class action complaint (the Amended Complaint) on June 22, 2012. The plaintiff purports to represent a class of persons who purchased or otherwise acquired K12 common stock between September 9, 2009 and December 16, 2011 (the Class Period), inclusive, and alleges violations by the defendants of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. The plaintiff alleges among other things that the defendants made false or misleading statements of material fact, or failed to disclose material facts, about (i) the Company s revenue and enrollment results during the Class Period, (ii) the academic performance of the virtual schools served by the Company, and (iii) certain school administrative practices and sales strategies related to enrollments. The plaintiff seeks unspecified compensatory damages and other relief. On September 18, 2012, the Court denied Defendants motion on the pleadings to dismiss the action, and permitted the case to proceed to the next stage of litigation. The Company intends to continue to vigorously defend against the claims asserted in the Amended Complaint. Discovery is ongoing in this matter.

In addition to the above described stockholder class action, on March 21, 2012, a federal stockholder derivative action, *Jared Staal v. Andrew H. Tisch,* et. al., Case No. I:12-cv-00365-SLR, putatively initiated on behalf of the Company, was filed in the United States District Court for the District of Delaware. By stipulation, all matters in this derivative action have been stayed.

The Board of Directors received a stockholder demand letter, dated August 16, 2012, that asserted allegations against various directors, senior officers and employees of K12 similar to those made in the previously disclosed securities class action and derivative lawsuits. The stockholder requested that the Board investigate and pursue claims related to breach of fiduciary duty on behalf of the Company. The Board has formed a demand evaluation committee, which has retained counsel to assist with its review of the demand. The Board will take appropriate action based on the committee s recommendation. On October 19, 2012, the Board received a stockholder demand pursuant to 8 Del. C. § 220 (a 220 Demand) from Oakland County Employees Retirement System to inspect certain categories of documents. The Board is considering the 220 Demand and will take appropriate action.

10. Investment and Acquisition

Investment in Web International Education Group, Ltd.(Web)

In January 2011, the Company invested $10.0 million to obtain a 20% minority interest in Web, a provider of English language learning centers in cities throughout China. The Company s option to purchase no less than 51% of Web has been extended to February 28, 2013 (from July 1, 2012) and the Company has the option to purchase all remaining equity interest of Web through December 31, 2015. The Company recorded its investment in Web as an available for sale debt security because of the ability to put the investment to other Web shareholders in return for the original $10.0 million investment plus interest. There has been no change to the fair value of the Web investment based on Web s financial performance since the initial investment and Web s ability to repay the investment plus interest with cash.

Acquisition of Kaplan/Insight Assets from Kaplan Virtual Education and Insight Schools, Inc.

On July 1, 2011, the Company acquired the Kaplan/Insight Assets for $12.6 million. The Kaplan/Insight Assets included contracts to serve nine virtual public charter schools throughout the United States that have been integrated into the Company s existing operations. The acquisition of the Kaplan/Insight Assets had an immaterial proforma impact on the results of operations for the three and six months ended December 31, 2011. The majority of the purchase price has been allocated to goodwill and intangible assets for $6.0 million and $4.3 million, respectively. The purchase price allocation was finalized as of September 30, 2012.

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11. Supplemental Disclosure of Cash Flow Information

	Six Months Ended December 31, 2012		(In thousands) 2011	
Cash paid for interest	$	515	$	471
Cash paid for taxes, net of refunds	$	430	$	50
Supplemental disclosure of non-cash investing and financing activities:				
New capital lease obligations	$	19,195	$	19,454
Business Combinations:				
Current assets	$		$	823
Property and equipment	$		$	1,310
Capitalized curriculum development costs	$		$	100
Intangible assets	$		$	3,115
Goodwill	$		$	6,777
Deferred tax liabilities	$		$	226
Foreign currency translation adjustments	$	257	$	

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

Certain statements in Management s Discussion and Analysis or MD&A, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives, and expected operating results, and the assumptions upon which those statements are based, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended or the Exchange Act. These forward-looking statements generally are identified by the words believe, project, expect, anticipate, estimate, intend, strategy, plan, may, should, will, would, will be, will continue, will likely result, and similar expressions. Historical results may not indicate future performance. Our forward-looking statements reflect our current views about future events, are based on assumptions and are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those contemplated by these statements. Factors that may cause differences between actual results and those contemplated by forward-looking statements include, but are not limited to, those discussed in Risk Factors in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended June 30, 2012, which we refer to as our Annual Report. We undertake no obligation to publicly update or revise any forward-looking statements, including any changes that might result from any facts, events, or circumstances after the date hereof that may bear upon forward-looking statements. Furthermore, we cannot guarantee future results, events, levels of activity, performance, or achievements.

This MD&A is intended to assist in understanding and assessing the trends and significant changes in our results of operations and financial condition. As used in this MD&A, the words, we, our and us refer to K12 Inc. and its consolidated subsidiaries. This MD&A should be read in conjunction with our condensed consolidated financial statements and related notes included in this report, as well as the consolidated financial statements and MD&A of our Annual Report. The following overview provides a summary of the sections included in our MD&A:

- *Executive Summary* a general description of our business and key highlights of the three and six months ended December 31, 2012.

- *Critical Accounting Policies and Estimates* a discussion of critical accounting policies requiring critical judgments and estimates.

- *Results of Operations* an analysis of our results of operations in our condensed consolidated financial statements.

- *Liquidity and Capital Resources* an analysis of cash flows, sources and uses of cash, commitments and contingencies, seasonality in the results of our operations and quantitative and qualitative disclosures about market risk.

Executive Summary

We are a technology-based education company. We offer proprietary curriculum, software systems and educational services designed to facilitate individualized learning for students primarily in kindergarten through 12th grade, or K-12. Our mission is to maximize a child s potential by providing access to an engaging and effective education, regardless of geographic location or socio-economic background. Since our inception, we have invested to develop and, to a lesser extent, acquire curriculum and online learning platforms that promote mastery of core concepts and skills for students of all abilities. K12 provides a continuum of technology-based educational products and solutions to districts, public schools, private schools, public charter schools and families as we strive to transform the educational experience into one that delivers individualized education on a highly scalable basis.

Virtual and blended public schools generally under turn-key management contracts (Managed Public Schools) accounted for approximately 86% of our revenue in the six months ended December 31, 2012. We currently provide management services to public schools in 33 states and the District of Columbia.

In addition to our Managed Public Schools, we serve an increasing number of schools and school districts enabling them to offer our course catalog to students either full-time or on an individual course basis. We have a

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growing sales team to focus on this sector and, through our acquisitions of KC Distance Learning, or KCDL, and The American Education Corporation, or AEC, in 2010, we increased the size and expertise of our sales team, added a reseller network and expanded our course portfolio. The services we provide to these schools and school districts are designed to assist them in launching their own online learning programs which vary according to the needs of the individual school and school district and may include teacher training programs, administrator support and our PEAK12 management system. With our services, schools and districts can offer programs that allow students to participate full-time, as their primary school, or part-time, supplementing their education with core courses, electives, credit recovery options, remediation and supplemental content options. We continue to provide these services to school districts or individual schools in all 50 states and the District of Columbia.

We also own and operate three online private schools where parents can enroll students on a tuition basis for a full-time online education or individual courses to supplement their children s traditional instruction. These include our K12 International Academy, an online private school that enables us to offer students worldwide the same full-time education programs and curriculum that we provide to the virtual and blended public schools, The Keystone School, a private school that offers online and correspondence courses, and the George Washington University Online High School, a program that offers a college preparatory focus and is designed for high school students who are seeking a challenging academic experience. In addition, we own and operate the International School of Berne, or IS Berne, a traditional private school located in Berne, Switzerland and a recognized IB school serving students in grades Pre-K through 12.

For the six months ended December 31, 2012, revenues grew to $427.1 million from $359.8 million in the same period in the prior year, a growth rate of 18.7%. Over the same period, operating income increased to $24.9 million from $15.4 million, a change of 62.3%, and net income to common stockholders increased to $13.9 million from $8.8 million, a change of 58.0%. These increases were primarily due to revenue growth between periods. We have reclassified certain prior year enrollment related costs from instructional costs and services to selling, administrative and other operating expenses to conform to the current year presentation. There was no effect on total costs and expenses, income from operations or net income from such reclassification.

Recent Acquisitions

During the periods presented, we completed the purchase of certain K-12 assets and Insight School management contracts of Kaplan Virtual Education, or KVE, a subsidiary of Kaplan, Inc. We refer to these assets as the Kaplan/Insight Assets, which included contracts to serve nine virtual public charter schools in eight states serving students in grades 6-12. The acquisition allows us to serve more students with multiple curriculum platforms and our existing virtual academy operations.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions about future events that affect the amounts reported in the accompanying condensed consolidated financial statements and notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our condensed consolidated financial statements. Critical accounting policies are disclosed in our Annual Report. There have been no significant updates to the critical accounting policies disclosed in our Annual Report.

Appointment of Executive Chairman

On January 7, 2013, our Board of Directors appointed our Chairman of the Board, Nathaniel A. Davis, as our Executive Chairman. Following his appointment, Mr. Davis became a full-time employee who directly supervises our operations and financial performance. Our Chief Executive Officer, Ronald J. Packard, continues to supervise corporate development, business development, academic achievement, and nascent business ventures. In addition, the Board appointed Jon Q. Reynolds as its Lead Independent Director. We believe these arrangements enhance our executive leadership team and organizational structure. Both Mr. Davis and Mr. Packard actively participate in our internal control and quarterly disclosure activities.

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Results of Operations

As described in the Annual Report, we reclassified our three lines of business: Managed Public Schools (turn-key management services provided to public schools), Institutional Sales (educational products and services provided to school districts, public schools and other educational institutions that we do not manage), and International and Private Pay Schools (private schools for which we charge student tuition and make direct consumer sales).

Managed Public Schools	Institutional Sales	International and Private Pay Schools
• Full-time virtual schools	• K12 curriculum	• Managed private schools
• Blended schools	• Aventa curriculum	The Keystone School
Flex schools	• A+ curriculum	George Washington University Online High School
Passport schools	• Middlebury joint venture	K12 International Academy
Discovery schools	• Pre-kindergarten	International School of Berne
Other blended schools	• Post-secondary	• Web International Education Group, Ltd. (via investment)
		• Independent course sales (Consumer)

Enrollment Data

The following table sets forth average enrollment data for students in Managed Public Schools and total enrollment data for students in the International and Private Pay Schools for the periods indicated. These figures exclude enrollments from classroom pilot programs and consumer programs.

	Three Months Ended December 31,	Six Months Ended December 31,